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# In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,
PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B–1—B–19) is reported at 306 F. 2d 824. The opinion of the district court (R. 64a–131a)[1] is reported at 199 F. Supp. 452.

### JURISDICTION

The judgment of the court of appeals was entered on July 30, 1962 (Pet. App. C–1—C–2). The petition for a writ of certiorari was filed on October 24, 1962. The time for filing the government's response was extended to December 13, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 2101 (c).

[1] "R. ——" references are to the Joint Appendix in the court of appeals.

## QUESTION PRESENTED

Whether the term "dividends," as used in Section 902(a) of the Internal Revenue Code of 1954, relating to the credit for foreign taxes, includes a distribution in complete liquidation of a wholly-owned foreign subsidiary.

## STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 316. DIVIDEND DEFINED.
>
> (a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—
>
> (1) out of its earnings and profits accumulated after February 28, 1913, or
>
> (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.
>
> * * * * *
>
> (26 U.S.C. 316.)
>
> SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.
>
> (a) *General Rule.*—
>
> (1) *Complete liquidations.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.
>
> * * * * *
>
> (26 U.S.C. 331.)

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. * * *

* * * * *

(26 U.S.C. 901.)

* * * * *

SEC. 902. CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION.

(a) *Treatment of Taxes Paid by Foreign Corporation.*—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

* * * * *

(26 U.S.C. 902.)

## STATEMENT

The petitioner ("Associated"), a Delaware corporation, filed a consolidated income tax return for 1954

with its wholly-owned American subsidiary, Automatic Electric Co. ("Automatic") which, in turn, was the sole stockholder of Filcrest Co., Ltd. ("Filcrest"), a Canadian corporation completely liquidated in 1954. The liquidating distribution to Automatic included earnings and profits of Filcrest upon which Canadian income taxes had previously been paid. Canadian income tax was also paid upon the liquidating distribution itself. The gain realized upon the liquidation was reported in the consolidated return as a long-term capital gain. (R. 42a–45a.)

Credits for foreign taxes were claimed on the consolidated income tax return under both Sections 901 and 902 of the Internal Revenue Code of 1954. The Commissioner allowed the Section 901 credit for the Canadian tax imposed directly upon the parent in connection with the payment of the liquidating distribution (R. 44a–45a). The Section 902 credit, however, for Canadian taxes paid by Filcrest upon the accumulated earnings and profits included in the liquidating distribution, was disallowed on the ground that a liquidating distribution is not a "dividend" for purposes of Section 902(a) of the Code. (R. 45a–46a.) Petitioner paid the tax and sued for a refund. The district court held that the liquidating distribution qualified as a "dividend" within the meaning of Section 902(a) and that the petitioner was entitled to the deemed paid credit. The court of appeals, reversing the district court on this issue,[2] held "that the term 'dividend' in Section 902(a) does not apply to liquidation distributions." (Pet. App. B–19.)

[2] Another consolidated returns issue decided for the government by the courts below is not raised by the petition.

## ARGUMENT

The decision below is correct, is not in conflict with any other decision, and presents no issue of continuing importance.

1. Under Section 902(a) of the 1954 Revenue Code, a domestic corporation, in any year it receives "dividends" from a foreign subsidiary, is "deemed to have paid," and hence is entitled to credit for the foreign income tax paid by the subsidiary on that portion of the accumulated earnings which the "dividends" represent. The sole question in this case is whether a "dividend," for purposes of this section, includes a distribution in complete liquidation of a wholly-owned subsidiary. The court of appeals properly held it did not.

In the landmark case of *Hellmich* v. *Hellman*, 276 U.S. 233, 237, this Court held that "as generally understood and used, [the term 'dividend'] refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock." A liquidating distribution, of course, does not meet this test.

The distinction between "dividends" and "distributions made to stockholders in the liquidation of a corporation," expounded by *Hellmich* v. *Hellman*, *supra*, in the context of the Revenue Act of 1918, c. 18, 40 Stat. 1057, has been maintained ever since and is now reflected in Sections 316 and 331 of the Internal Revenue Code of 1954, *supra*, p. 2. Under the latter section, distributions in liquidation, unlike dividends,

are "treated as * * * payment in exchange for the stock," and have tax consequences completely different from those attaching to dividends. See, e.g., *Foster* v. *United States*, 303 U.S. 118. Indeed, the present petitioner had the benefit of that distinction when it obtained long-term capital gain, rather than ordinary income, treatment upon liquidation of the Canadian subsidiary. (R. 45a.)

2. The petition alleges no direct conflict with any other decision, and there is none. On the contrary, the decision below is in accord with those of the Seventh Circuit in *Fowler Hosiery Co.* v. *Commissioner*, 301 F. 2d 394, and of the Court of Claims in *Freeport Sulphur Co.* v. *United States*, 163 F. Supp. 648, addendum, 172 F. Supp. 462. Although the opinions vary somewhat in the weight placed upon particular arguments supporting the government's position,[3] they are in full agreement in their construction of the statutory language. If anything, these differences in emphasis merely demonstrate that there are additional valid grounds for the decision below.

Furthermore, the "rules enunciated by this Court," upon which petitioner relies, bear on this case only remotely, if at all. *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, 289 (see Pet. 7–8), involved the question

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[3] For example, the Seventh Circuit and the Court of Claims placed greater weight than did the court below upon this Court's decision in *Hellmich* v. *Hellman*, 276 U.S. 233. Also, the court below, unlike the Seventh Circuit, did not rely upon the 1950 comment of the House Ways and Means Committee (H. Rep. No. 2319, 81st Cong., 2d Sess., p. 52 (1950–2 Cum. Bull. 380, 419–420) on proposed Section 206 of the Revenue Bill of 1950), to the effect that the indirect foreign tax credit is not available with respect to distributions in liquidation of foreign corporations.

whether a cash "boot" distributed to a taxpayer on the recapitalization of a corporation "has the effect of the distribution of a taxable dividend" under Section 112(c)(2) of the 1936 Revenue Act, and therefore was properly taxed at ordinary income rates, notwithstanding taxpayer's argument that the distribution more nearly had the effect of a "partial liquidation" under Section 115(i) of that Act. In requiring dividend treatment, this Court did not hold, as petitioner here suggests, that payments admittedly taxable as liquidating distributions under what is now Section 331 must for all other purposes be considered as dividends. *American Chicle Co.* v. *United States*, 316 U.S. 450 (see Pet. 8–9), states merely that the general purpose of Section 902(a) is to avoid double taxation; it does not deal even inferentially with the question presented here. The remaining "rules" allegedly contravened by the decision below are merely general guides to statutory construction which were given their proper weight.

3. Recent amendments of the Internal Revenue Code deprive the present case of any significance with respect to similar distributions of earnings and profits accumulated in taxable years beginning subsequent to December 31, 1962. Section 1248 of the Code, added by Section 15 of the 1962 Revenue Act,[4] 76 Stat. 960,

[4] The relevant portions of Section 15 are as follows:

(a) TREATMENT OF GAIN FROM THE REDEMPTION, CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN CORPORATIONS.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is

1041, substantially ends the capital gains treatment of accumulated earnings and profits of a foreign corporation when distributed in liquidation to an American stockholder owning at least 10 percent of the voting stock. Instead, the gain realized by the stockholder on the liquidating distribution, to the extent

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amended by adding after section 1247 (as added by section 14 of this Act) the following new section:

"SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—If—

"(1) a United States person sells or exchanges stock in a foreign corporation, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock, and

"(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. * * *"

* * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to sales or exchanges occurring after December 31, 1962.

See also new Sections 951–964 of the Code, added by Section 12 of the 1962 Act.

it is attributable to accumulated earnings and profits, will be taxed as a dividend, at ordinary income rates.

Significantly, the Senate Finance Committee report on the new section states (S. Rep. No. 1881, 87th Cong., 2d Sess., p. 300; see also H. Rep. No. 1447, 87th Cong., 2d Sess., p. A124):

> To the extent gain is included in gross income as a dividend, the pertinent rules of subpart A of part III of subchapter N, relating to foreign tax credits, apply. Thus, foreign-tax credits for amounts allowed under section 901(b) with respect to taxes paid, and section 902 with respect to taxes deemed to be paid, are allowable if the U.S. person chooses to have the benefits of such sections. That part of the gain in excess of the amount included in gross income as a dividend under section 1248 is treated as provided by the code without regard to new section 1248 *and there is no foreign tax credit with respect to taxes paid by the foreign corporation as to the portion of the gain that is not a dividend.* [Emphasis supplied.]

It is clear, therefore, that the future treatment of liquidating distributions such as the one involved here has been definitively settled by Congress. For taxable years commencing on or after January 1, 1963, the foreign tax credit provided by Section 902(a) will be available as to that portion of a liquidating distribution which is taxable to the American stockholder as a dividend at ordinary income rates, but will be unavailable as to that portion of the distribution which is taxable at capital gain rates. In light of this new provision, resolution of the issue by this Court is unnecessary

## CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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